

## **I. IRC 527 - POLITICAL ORGANIZATIONS**

### **1. Introduction and Background**

Until 1975, the Code did not specifically address the tax status of political organizations, such as political parties, campaign committees, and political action committees (PACs). When the issue was addressed at all, their tax treatment was governed by Service administrative interpretations.

Rev. Proc. 68-19, 1968-1 C.B. 810, held that "political funds" were not taxable to the candidate on whose behalf they were collected. The tax treatment of political parties and committees, however, was not addressed until 1973, when the Service published Announcement 73-84, 1973-2 C.B. 461. In that announcement, the Service concluded that no specific provision in the Code justified its "long-standing practice" not to require political organizations to file returns and pay tax. Therefore, the investment income of political parties and committees, including dividends, interest, and capital gains, was subject to tax. The announcement noted, however, that the Service would defer enforcement until Congress had given the problem specific consideration.

Those rules set forth in Announcement 73-84 were restated in Rev. Rul. 74-21, 1974-1 C.B. 14, clarified in, Rev. Rul. 74-475, 1974-2 C.B. 22. The revenue ruling concluded, on a prospective basis, that political organizations were not exempt from federal income tax, and would be taxed on interest, dividends, and capital gains from sales of securities, less deductible expenses directly attributable to producing that income. Organizations subject to tax were required to file Form 1120.

As Announcement 73-84 indicates, the tax treatment of political parties was being considered by Congress in 1973. When then Secretary of the Treasury, George Schultz, appeared before the Ways and Means Committee in April 1973 to testify on tax reform, he discussed the need to spell out the rules on the taxation of political parties. Congressional response was to enact IRC 527, effective for tax years beginning after December 31, 1974.

IRC 527 provides that "political organizations" are subject to tax only to the extent provided for in that section. For all other purposes under federal law, they are treated as tax exempt organizations. IRC 527 imposes a tax on the "political organization taxable income" of political organizations - broadly speaking, income

from sources other than contributions, membership dues, and fundraising events. (For most political organizations this means income from passive investments such as interest, dividends, and capital gains.) Where otherwise exempt income is not used for the political purposes that are the basis of these organizations' exemption, it is treated as "political organization taxable income" as well.

IRC 527 also establishes rules for when expenditures of funds by political organizations will be included in gross income of individuals. Finally, it provides special rules for "newsletter funds" maintained by holders of and candidates for public office, and for IRC 501(c) organizations that engage in political activity.

Effective October 1, 1988, the Exempt Organizations function of the Service assumed responsibility for interpreting and administering IRC 527. This article discusses IRC 527 as it relates to political organizations, and updates an article in the 1983 CPE text on 501(c) exempt organizations and IRC 527.

## 2. "Exempt Function"

### A. Introduction

The key concept in IRC 527 is that of "exempt function." (The term is defined in IRC 527(e)(2).) By definition, political organizations are entities that are organized and operated for the purpose of collecting contributions for or making expenditures for an "exempt function." Income from contributions, membership dues, political fundraising events, and from the sale of campaign material must be set aside or spent for "exempt function" purposes or it is taxable to a political organization. Finally, organizations exempt under IRC 501(c) may be subject to tax on amounts spent directly on an "exempt function."

### " B. What is "Exempt Function"?

IRC 527(e)(2) defines "exempt function" as "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual electors are selected, nominated, elected, or appointed."

In determining whether an activity is part of an IRC 527 organization's "exempt function," i.e., the function of influencing or attempting to influence the selection process, one must examine the relationship between the activity and the

purpose defined above. The regulations divide exempt function activities (expenditures) into those that are "directly" and "indirectly" related to this purpose.

"Directly related expenses" are defined in section 1.527-2(c)(1) of the regulations to include all activities directly related to and supporting the selection process. (The regulations use the term "selection process" to refer to the process of "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization." Reg. 1.527-2(c)(1). Section 1.527-2(d) of the regulations delineates when an office will be considered a "public office.")

Generally, where an organization supports an individual's campaign for public office, its activities and expenditures in the campaign further the selection process. The individual need not be an announced candidate for the office; that he or she never becomes a candidate is not crucial. Reg. 1.527-2(c)(1).

Thus, travel, lodging, and meal expenses incurred for a candidate traveling through a state to rally support for his or her election to public office in that state are expenditures for an exempt function. Reg. 1.527-2(c)(5)(i). Similar expenditures for the candidate's spouse are also for an exempt function if the spouse's participation is important to the candidate's election. Reg. 1.527-(c)(5)(ii). Directly related expenses for exempt functions also include those for voice and speech lessons a candidate takes to improve skills for a campaign, Reg. 1.527-2(c)(5)(iii); and those to attend a testimonial dinner to aid a public office holder's re-election, Reg. 1.527-2(c)(5)(iv). Expenditures for an election night party for political campaign workers are "an inherent part of, and the traditional public culmination of, the selection process," and therefore for an exempt function. Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 1. Similarly, cash awards to campaign workers after the election are for an exempt function if the amount given each worker is reasonable, considering the exempt function services the worker rendered and the amount of other compensation, if any, already paid. Id., Q&A 2. Expenditures to generate support for candidates with political philosophies in harmony with that of an IRC 527 organization, such as those to finance seminars and conferences, are also for an exempt function. See Reg. 1.527-(c)(5)(viii).

That activities need not seek to influence a particular candidate's or office holder's own selection process is illustrated by Rev. Rul. 79-12, 1979-1 C.B. 208. In that ruling, an elected legislator expended surplus political campaign funds to attend a political party convention, an activity involving the selection process. Therefore, the amounts were exempt function expenditures. Similarly, amounts

expended for voter research, public opinion polls, and voter canvasses for a second office, drawn from surplus campaign funds from an earlier campaign, are for an exempt function (and not taxable to the candidate under IRC 527(d), see infra). Rev. Rul. 79-13, 1979-1 C.B. 208.

Expenditures to purchase periodicals to enable an office holder to keep informed on national and local issues, however, do not relate to or support the selection process and are therefore not for an exempt function. Reg. 1.527-2(c)(5)(v). Similarly, expenses incurred by an incumbent's campaign staff in connection with work on a legislative item are not part of the selection process and therefore are not for an exempt function. See Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 4. Excess campaign funds transferred to an office holder's office expense account are likewise not for an exempt function. Rev. Rul. 80-331, 1980-2 C.B. 29.

An activity engaged in between election cycles is an exempt function activity if it is directly related to the selection process in the next applicable political campaign. Reg. 1.527-2(c)(1). The legislative history provides examples of permissible exempt function activities for a local political party between elections: preparing for the next party convention, fundraising, and transacting intra-party or organizational business. See S. Rep. No. 1357, 93d Cong., 2d Sess. 27 (1974), reprinted in 1975-1 C.B. 517, 532; see also Reg. 1.527-2(c)(5)(vii).

"Exempt function" also includes "indirect expenses," defined in section 1.527-2(c)(2). Indirect expenses are for an exempt function if "necessary to support the directly related activities of the political organizations," i.e., "those which must be engaged in to allow the political organization to carry out the activity of influencing or attempting to influence the selection process." For example, a political organization's solicitation of contributions is an exempt function activity. Similarly, expenses for overhead and record keeping are for an exempt function.

G.C.M. 39178 (March 6, 1984) provides a good example of qualifying indirect expenses. In this G.C.M., a corporation was organized and wholly controlled by an IRC 527 political organization and its related organizations, all of which were likewise IRC 527 political organizations. The corporation's purpose was to construct, own, and operate a building to house the headquarters of the related organizations. The G.C.M. concluded the expenditures described were "indirect expenses" necessary to support the direct political activities of the related organizations, and therefore qualified as exempt function expenditures under Reg. 1.527-2(c)(2).

The process of terminating a political organization's existence is an exempt function, under section 1.527-2(c)(3) of the regulations. Thus, where an organization is established to further a single campaign, its activities after the campaign ends in paying campaign debts, winding up the campaign, and putting its records in order are for an exempt function.

Illegal activity is not part of an IRC 527 organization's exempt function, even if engaged in to influence or attempt to influence the selection process. Reg. 1.527-2(c)(4). Thus, if expenditures are illegal (for example, exceed limits set in applicable campaign laws) or for a judicially determined illegal activity, they are not for an exempt function. Section 1.527-5(a)(2) of the regulations further explains which expenditures are not for an exempt function because they are illegal, in the context of defining what activities result in gross income to individuals or to the political organization. The regulation says payment for legal expenses to defend civil or criminal suits against the political organization or individuals acting on its behalf are for an exempt function if the organization can demonstrate the payments are not part of the inducement to engage in the illegal activity or part of the agreed upon compensation therefor. Reg. 1.527-5(a)(2).

As indicated above, the "selection process" refers to the process of "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization." Regs. section 1.527-2(d) provides that principles consistent with those in Reg. 53.4946-1(g)(2), defining "public office" for purposes of defining "disqualified person" in the private foundation context, apply. Thus, the essential element in deciding if a public position is a "public office" is whether the public employee independently performs policy-making functions as a significant part of his or her activities. Reg. 53.4946-1(g)(2)(i). Relevant to this determination is whether the office is created by or under authority granted by a state or other government subdivision's legislature or constitution; and whether the powers conferred on and duties discharged by the office are defined directly or indirectly by Congress, a state constitution or legislature, or through legislative authority. In G.C.M. 39694 (January 21, 1988), which relates to Announcement 88-112, 1988-37 C.B. 26 (Sept. 12, 1988), Chief Counsel concluded that the position of federal judge is a "public office" for purposes of IRC 527.

### C. Diversions for Personal Use - IRC 527(d)

Amounts diverted for the candidate's personal use are not expenditures for an "exempt function." By the same token, amounts expended for an exempt

function, as defined in IRC 527(e)(2), are not diversions for personal use. Thus, for example, a political organization may reimburse a government official's actual expenses for travel to a political fundraising events; such amounts are "expenditures" for an exempt function and therefore not income to the government official. Rev. Rul. 80-348, 1980-2 C.B. 31. Illegal expenditures, however, are never for an exempt function and therefore may well be income to the individual on whose behalf they are made (and taxable income to the organization making them). See Reg. 1.527-5(a)(2).

IRC 527(d) specifies certain situations where a political organization's expenditures will be deemed not to have been made for the personal use of a candidate. Specifically allowed expenditures are:

- (1) contributions to or for the use of another political organization treated as exempt under IRC 527(a) (including a newsletter fund under IRC 527(g), see Reg. 1.527-5(b)(1));
- (2) contributions to or for the use of 501(c)(3) organizations that are not private foundations because they are described in IRC 509(a)(1) or (2) (see also Reg. 1.527-5(b)(2)); and
- (3) deposits to the general fund of the Treasury or any state (including the District of Columbia, see S. Rep. No. 1357, op. cit., p. 31, or local government (see also Reg. 1.527-5(b)(3))).

IRC 527(d) indicates that no deduction will be allowed for amounts spent for the purposes listed above. Thus if a political organization makes a distribution to a public charity described in IRC 509(a)(1) or (2), it cannot take an IRC 170 deduction for the distribution when it computes its political organization taxable income. (See also IRC 527(c)(1)(B), which indicates political organization taxable income is determined by allowing the deductions "directly connected with the production of income," and S. Rep. No. 1357, op. cit., p. 31). The Service has not ruled on this question, however.

The legislative history indicates the tax treatment of diversions for personal use is the same as under prior law. Thus, when a candidate diverts an amount from a political organization for personal use, the amount is taxable income to the candidate in the year diverted. S. Rep. No. 1357, op. cit., p. 31.

The regulations say payments are for "personal use" where direct or indirect financial benefit accrues to individual(s). Reg. 1.527-5(a)(1). Thus, if a political organization satisfies a candidate's legal obligation, as by paying his federal income tax, this is a diversion for personal use even though the amount is deposited in the general fund of the Treasury. Similarly, using campaign funds to satisfy an individual's legally binding pledge to contribute to a public charity is a diversion for personal use. Where unexpended campaign funds are held by a candidate who dies, and go to the candidate's estate or survivors, the transfer will not be income of the decedent if transferred as specified in IRC 527(d) within a reasonable period of time. Reg. 1.527-5(c)(2). This does not apply, however, if the decedent provided for the estate to receive the funds.

Reg. 1.527-5(c) details how excess campaign funds - funds controlled by a political organization or other person after a campaign - are treated. The regulation says such funds are treated as diverted for personal use of the person who controls them, except to the extent: (i) transferred within a reasonable period of time, in accordance with Reg. 1.527-5(b), i.e., for a use listed in IRC 527(d)(1)-(3); or (ii) held in reasonable anticipation of use by the political organization for exempt functions.

Thus, a political organization's expenditure of excess campaign funds from one campaign to pay expenses of the candidate's campaign for a second office are for an exempt function and do not result in income to the candidate. Rev. Rul. 79-13, 1979-1 C.B. 208. Similarly, an elected legislator may expend surplus campaign funds to defray expenses of attending a political convention, an exempt function activity, without receiving taxable income. Rev. Rul. 79-12, 1979-1 C.B. 208. In contrast, where expenditures that benefit a candidate are not for an exempt function, the candidate will have gross income (and the political organization will have taxable income). For example, excess campaign funds transferred to an office holder's office expense account are not for an exempt function; amounts thus transferred are considered diverted to the office holder's personal use. Rev. Rul. 80-331, 1980-2 C.B. 29. This conclusion was reached even though the Federal Election Campaign Act, 2 U.S.C. Section 439a, permits transfers of funds to office accounts if not needed to defray campaign expenditures.

### 3. IRC 527 - Specific Requirements

#### A. Qualification of Political Organizations

While no application is needed to establish exemption under IRC 527, its exemption and taxation provisions apply only to "political organizations" as defined in IRC 527(e)(1). IRC 527(e)(1) says "political organization" means a "party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function" (i.e., to influence or attempt to influence the selection process).

The regulations say that qualified organizations include a committee or other group which accepts contributions or makes expenditures to promote the nomination of an individual for an elective public office in a primary election, or in a meeting or caucus of a political party. Reg. 1.527-2(a)(1).

To qualify for exemption under IRC 527, an organization must satisfy organizational and operational tests. To satisfy the organizational test, Reg. 1.527-2(a)(2), the organization's articles of organization must provide that its primary purpose is to carry on one or more exempt functions. If it has no formal articles of organization, consideration is given to statements (such as a resolution) of the organization's members when it was formed that they intend to operate the organization primarily to carry on exempt functions.

Thus, a political organization is not required to be formally established as a corporation, trust, or association. For example, in Rev. Rul. 79-11, 1979-1 C.B. 207, a candidate received political campaign funds that were deposited in a separate bank account and disbursed only for bona fide political campaign expenses. The ruling held the account qualified as a political organization under IRC 527(e)(1).

To satisfy the operational test, Reg. 1.527-2(a)(3), an organization need not engage exclusively in exempt function activities. (Compare the treatment of newsletter funds under IRC 527(g), *infra*.) Thus, a political organization may (i) sponsor non-partisan educational workshops that are not intended and do not attempt to influence the selection process; (ii) pay an incumbent's office expenses; and (iii) carry on social activities unrelated to its exempt function, provided these are not its primary activities. Also, a political organization need not operate in accordance with corporate formalities established in by-laws or under state law. Id.; see also Rev. Rul. 79-11, supra.

G.C.M. 39178 (March 6, 1984) concluded that an organization that had no direct exempt function activities qualified as a "political organization" under IRC



527(e)(1). In addition, the G.C.M. said the organization, which operated a building housing a number of affiliated IRC 527 organizations that wholly controlled it, could lease 10% of the building's space to non-IRC 527 third parties, since its "primary purpose" was nevertheless to carry on an exempt function.

#### B. Imposition and Rate of Tax - IRC 527(a) and (b)

**General rule.** IRC 527(a) provides that a "political organization" is subject to tax only under that section. Thus, Rev. Rul. 74-21, supra, is superseded. Under IRC 527(a), a political organization is deemed exempt from income taxes for purposes of any law referring to such organizations.

The tax on political organizations is imposed by IRC 527(b). IRC 527(b)(1) imposes a tax on "political organization taxable income" of every "political organization." In general, the tax is computed by multiplying political organization taxable income by the highest rate of tax specified in IRC 11(b). In other words, political organization taxable income is taxed at the highest corporate rate.

**Alternative tax on capital gains.** If a political organization has net capital gains, then under IRC 527(b)(2), its tax is the lesser of the tax under IRC 527(b)(1) or the sum of the tax under IRC 527(b)(1) on non-capital gains income plus the amount of capital gains tax determined under IRC 1201(a).

**"Principal campaign committees" - special rule.** IRC 527(h)(1) provides a special rule for "principal campaign committees," effective for taxable years beginning after December 31, 1981. Such committees pay tax at the "appropriate" rates (depending on the amount of taxable income) under IRC 11(b), rather than the highest rate. Thus, a principal campaign committee's tax would generally be lower than that imposed under the general rule in IRC 527(b)(1). "Principal campaign committee" is defined in IRC 527(h)(2) as a political committee designated by a candidate for Congress as his or her principal campaign committee for purposes of either section 302(e) of the Federal Election Campaign Act of 1971, 2 U.S.C. Section 432(e), or IRC 527(h)(2)(A).

Reg. 1.527-9 specifies the circumstances and manner in which a "principal campaign committee" may be designated. Only candidates for Congress may designate a principal campaign committee. Under 11 C.F.R. Section 102.12, no political committee may be designated as principal campaign committee for more than one candidate, and no political committee that supports or has supported more than one candidate may be designated as a principal campaign committee. No

designation need be made where a Congressional candidate has only one political campaign committee.

To designate a principal campaign committee pursuant to IRC 527(h) and Reg. 1.527-9(b), a candidate must append a copy of his or her Statement of Candidacy (FEC Form 2, or equivalent statement filed with Federal Election Commission under 11 C.F.R. Section 101.1(a)) to the committee's Form 1120-POL for the taxable year for which the designation is effective. Alternatively, the candidate may append a statement containing the candidate's name and address; Taxpayer Identification Number; party affiliation and office sought; district and state where office sought; and name and address of principal campaign committee. Any designation must be made on or before the due date (as extended) for filing Form 1120-POL.

A designation may be revoked only in accordance with Reg. 1.527-9(c), which requires the Commissioner's consent. The Commissioner generally will consent where the Congressional candidate complies with FEC requirements for revoking the designation, by filing an amended Statement of Designation or equivalent under 11 C.F.R. Section 102.2(a)(2). To determine the appropriate rate of tax under IRC 11(b) for a taxable year where a candidate revokes a designation and designates a new principal campaign committee, the taxable income of the first (revoked) committee is treated as that of the subsequent (newly-designated) committee. The Commissioner may condition consent to revocation on the candidate's agreeing to ensure compliance with this requirement.

### C. Taxable Income - IRC 527(c)

IRC 527(c) provides definitions and rules used in determining the taxable income of a political organization. In most circumstances, only net investment income and business income are taxed.

IRC 527(c)(1) defines "political organization taxable income" (or "taxable income") as an amount equal to the organization's gross income (excluding exempt function income) over deductions allowed by Chapter 1 of the Code which are directly connected with producing gross income (excluding exempt function income), computed with the modifications provided in IRC 527(c)(2). IRC 527(c)(2) provides three modifications: (A) a specific deduction of \$100 is provided (which is not allowed to "newsletter funds" under IRC 527(g)(2), see *infra*); (B) no net operating loss deduction under IRC 172 is allowed; and (C) no

deductions are allowed under part VIII of subchapter B of the Code (IRC 241-250), relating to special deductions for corporations.

The legislative history indicates indirect expenses (such as general administrative expenses) are not allowed as deductions "since it is expected that these amounts will be relatively small and eliminating these deductions will greatly simplify tax calculations." S. Rep. No. 1357, op. cit., p. 29.

Expenses, depreciation, and similar items must both qualify as deductions allowed under Chapter 1, and be "directly connected" with producing political organization taxable income. Reg. 1.527-4(c)(1). To be "directly connected," a deduction item must have a proximate and primary relationship to producing taxable income and have been incurred in producing such income. Reg. 1.527-4(c)(2). If an item is attributable solely to producing taxable income, it is allowed under IRC 527. Thus, Rev. Rul. 85-115, 1985-2 C.B. 172, held that where state income taxes a political organization paid on non-exempt function income were attributable solely to items of taxable income, they bore a "proximate and primary relationship" with producing that income. Since IRC 164 provides a deduction for such taxes in the year paid or accrued, they were allowed as a deduction under IRC 527(c)(1) in the year paid.

Whether the requisite relationship exists depends on all relevant facts and circumstances. (Compare UBIT rules, Reg. 1.512(a)-1(a)-(b).) The regulations further provide that if an organization has a net capital loss, then the rules of IRC 1211(a) and 1212(a) apply. Thus, capital losses are allowed only to the extent of capital gains; and net capital losses may be carried back for three and forward for five years. Where facilities or personnel are used both for exempt function and taxable purposes, deductions relating to that use must be allocated between exempt function and taxable income. Reg. 1.527-4(c)(3) requires that such an allocation be "on a reasonable and consistent basis." Time spent on exempt function and taxable activities is a permitted basis for allocating salaries of personnel, for example. (Compare Reg. 1.512(a)-1(c).)

#### D. "Exempt Function Income" - IRC 527(c)(3)

**General rule.** The tax imposed by IRC 527(b) applies only to the part of a political organization's gross income that is not "exempt function income" as defined in IRC 527(c)(3). "Exempt function income" means any amount received as one of four specific types of receipts, to the extent segregated for use only for the political organization's exempt function (i.e., to influence or attempt to

influence the selection process). Income is "segregated for use only for an exempt function" only if received into and disbursed from a segregated fund defined in Reg. 1.527-2(b).

A "segregated fund" is a fund established and maintained by an organization or individual separate and apart from other assets. The fund's purpose must be to receive and segregate exempt function income (and earnings thereon) for use only for an exempt function. A segregated fund must be clearly identified and established for the purposes intended. Reg. 1.527-2(b)(1).

Amounts in a segregated fund must be dedicated for use only for an exempt function. Expenditures may be made from the fund, if for an exempt function, to establish or administer a political organization or to solicit political contributions. But if an organization establishes a segregated fund and spends more than an insubstantial amount from it for non-exempt function activities during a taxable year, it will not be treated as a segregated fund (or a political organization) for the year. Furthermore, if more than insubstantial amounts were expended for non-exempt function activities in prior years, facts and circumstances may indicate the fund was never a qualified "segregated fund." Reg. 1.527-2(b)(1).

Adequate records on segregated funds must be maintained to verify receipts and disbursements and to identify the exempt function activity for each expenditure. Reg. 1.527-2(b)(2).

Receipts in the following forms may be exempt function income:

- (A) **Contribution of money or other property**: Under IRC 527(e)(3) and Reg. 1.527-3(b), "contribution" has the meaning given in IRC 271(b)(2) (relating to political organization bad debts). That section says the term includes a gift, subscription, loan, advance, or deposit, of money or anything of value, and includes a contract, promise, or agreement to make a contribution, whether legally enforceable. Thus, generally, money or other property, whether solicited personally, by mail, or through advertising, qualifies as a contribution. In addition, funds received under the personal income tax return "checkoff" provision (IRC 9001-9013) or similar campaign financing provisions are treated as contributions.

The legislative history indicates exempt function income may be received indirectly as well as directly. In discussing the

qualification of political organizations, the Senate report states: "An organization may qualify as a political organization if it indirectly receives or expends money for campaign purposes. For example, if a national organization receives political contributions indirectly through local organizations, it would be indirectly accepting contributions and would qualify under the bill." S. Rep. No. 1357, op. cit., p. 27 (emphasis supplied). The language of IRC 527(e)(1), defining "political organizations" with which IRC 527 is concerned, similarly indicates indirect contributions are a permissible form of exempt function income. IRC 527(e)(1) defines the exempt purpose of a political organization as "directly or indirectly accepting contributions or making expenditures ... for an exempt function" (emphasis supplied).

G.C.M. 39178 (March 6, 1984), relied on the quoted passage from the Senate Report in concluding that an organization that constructed, owned, and operated a building to house the headquarters of the IRC 527 organizations that controlled it received "exempt function income" from sharing expenses of the buildings with the related organizations. The payments from other IRC 527 organizations for shared expenses were indirect contributions to the organization, the G.C.M. said.

- (B) **Membership dues, a membership fee or assessment from a member of the political organization:** Reg. 1.527-3(c) provides that amounts denominated "membership dues" or "fees" are not exempt function income if received in consideration for services, goods, or other items of value. However, filing fees an individual pays directly or indirectly to a political party, to run as a candidate in the party primary or in the general election as a party candidate, are exempt function income. For example, some states require certain public office holders to pay a percentage of their first year's salary for the office to the state as a filing or "qualifying" fee or party assessment; the state then transfers the amount to the party. The transferred amount is exempt function income, as are amounts the individual pays directly to the party as a qualifying fee. Id.
- (C) **Proceeds from political fundraising or entertainment events or sale of political campaign materials, which are not received in the ordinary course of any trade or business:** To generate exempt

function income, a fundraising event must be "political in nature" and "not carried on in the ordinary course of a trade or business." Reg. 1.527-3(d)(1). Whether an event is "political in nature" depends on all relevant facts and circumstances. One factor is the extent the event is related to a political activity aside from the organization's need for income or funds. Originally, proposed regulations would have adopted a "substantially related" test similar to that in IRC 513(a) and applicable regulations. This was rejected in favor of the above formulation, providing that the relationship is only one relevant factor. See T.D. 7744, 1981-1 C.B. 360, 361.

Whether a fundraising event is carried on "in the ordinary course of a trade or business" depends on all relevant facts and circumstances. Reg. 1.527-3(d)(2). Relevant factors include the activity's frequency, the manner in which it is conducted, and the span of time over which it is carried out. (Compare Reg. 1.513-1(c)(1) (when trade or business is "regularly carried on" for purposes of applying UBIT).) In general, proceeds from "casual, sporadic" fundraising are not received in the ordinary course of a trade or business. For example, income from an annual political dinner or athletic exhibition would be exempt function income. Income from similar events, such as political breakfasts, receptions, picnics, and dances would also be exempt function income if the event otherwise qualified under IRC 527(c)(3)(C). See S. Rep. No. 1357, op. cit., p. 28, which provides these examples.

Under IRC 527(c)(3)(C), proceeds from sale of political campaign materials are exempt function income if the sale is not in the ordinary course of a trade or business (see Reg. 1.527-3(d)(2), *supra*) and is related to exempt function activity aside from the organization's need for income or funds. Reg. 1.527-3(e). Items sold may include political memorabilia, bumper stickers, campaign buttons, hats, shirts, posters, stationery, jewelry, or cookbooks, where identified as relating to the distribution of political literature or organizing voters to vote for a candidate.

These provisions were applied in Rev. Rul. 80-103, 1980-1 C.B. 120, where a political organization sold reproductions of an original work of art, not of a political nature, the artist had donated to it. The reproductions were sold over a period of several months

through an art gallery, to which the organization paid a fee. Rev. Rul. 80-103 held the proceeds were not exempt function income. The sales were solely for fundraising purposes, and were not related to the organization's political activity aside from its need for funds. Nor were the sales "casual" and "sporadic," see Reg. 1.527-3(d)(2), but instead extended over a period of several months. "Therefore, the proceeds from the sales (1) were not received from a . . . political fund raising event or activity, and (2) were received in the ordinary course of a trade or business. Also, the sales were not sales of political campaign materials, since the art work was not of a political nature."

**(D) Proceeds from conducting any bingo game (defined in IRC 513(f)(2))**

**E. Newsletter Funds - Special Rules - IRC 527(g)**

Many elected officials establish funds to accept contributions and pay for newsletters to constituents. Before IRC 527 was enacted, the Service treated contributions to such funds as income to the elected official in the year received. Amounts spent for the newsletter - printing and addressing costs, for example - were deductible as ordinary and necessary business expenses, if the elected official itemized deductions. See S. Rep. 1357, op. cit., p. 33. Over time, income and expenses would be roughly equal.

Congress believed this treatment "improperly affect(ed)" elected officials' taxable income, since income might be reported in one year and expenses deducted in another. Reporting income separate from expenses of producing it affected other deduction items, such as charitable contributions and medical expenses, where the availability and amount of deductions is based in part on a percentage of the individual's adjusted gross income. Furthermore, if an official did not itemize, he could not deduct newsletter expenses. S. Rep. 1357, op. cit., p. 33.

Congress rectified this perceived inequity via IRC 527(g). In general, newsletter funds are treated like political organizations; their exempt function - the function for which they must be organized and operated and income from which is non-taxable - is limited to newsletter-related activities, however.

IRC 527(g)(1) provides that newsletter funds shall, except as provided in IRC 527(g)(2), be treated as if they were political organizations. A newsletter fund

is a fund established and maintained by an individual who holds, has been elected to, or is a candidate for nomination or election to, any federal, state, or local elective public office, for use by the individual exclusively to prepare and circulate the individual's newsletter. Thus, unlike a political organization, which may conduct non-exempt function activities that are not its primary activities, a newsletter fund must operate exclusively for its exempt purposes.

The treatment of newsletter funds differs somewhat from that of political organizations. First, IRC 527(g)(2) provides that in determining a newsletter fund's taxable income, its "exempt function" (income from which is not taxable) is limited to preparing and circulating the newsletter. IRC 527(g)(2)(A). Second, newsletter funds are not allowed the specific \$100 deduction allowed political organizations under 527(c)(2). IRC 527(g)(2)(B).

Thus, expenditures for secretarial services, printing, addressing, and mailing the newsletter would be exempt function expenditures for a newsletter fund. Reg. 1.527-7(c). Newsletter funds may not, however, be used for campaign activities or other activities that are an "exempt function" for a political organization, Reg. 1.527-7(d)(1); nor may they transfer unexpended amounts from the fund to a qualified political organization (which would be permitted a political organization, pursuant to IRC 527(d)), Reg. 1.527-7(d)(2). Permissible diversions for newsletter funds are limited to contributions to charitable 509(a)(1) or (2) organizations; deposits to the general fund of the Treasury or a state or local government; or contributions to another newsletter fund described in Reg. 1.527-7(a). Reg. 1.527-7(e).

IRC 527(g)(3) defines "candidate," for purposes of delineating who is permitted to maintain a newsletter fund, as an individual who publicly announces he or she is a candidate for nomination or election to federal, state or local elective public office, and meets the legal qualifications to hold the office. This definition was added by the Tax Reform Act of 1986, P.L. 99-514, Section 112(b)(1)(B), 100 Stat. 2086, for tax years beginning after December 31, 1986. For prior years, the regulation's definition adopting the meaning in IRC 41(c)(2), applies. See Reg. 1.527-7(a).

#### F. Assessment, Collection, and Returns of Tax

Since taxes imposed by IRC 527 are imposed by Subchapter A of the Code, all provisions of the Code and regulations that apply to Subchapter A taxes apply to assessment and collection of IRC 527 taxes. Thus, organizations subject to tax



under IRC 527 are subject to the provisions, including penalties, for corporations generally. However, the requirements for paying estimated taxes (now contained in IRC 6655(g) for corporations) do not apply.

The regulation excepting IRC 527 organizations from estimated tax provisions may have been based on the need for parity between IRC 501(c) and IRC 527 organizations. See Reg. 1.527-8(a). The Tax Reform Act of 1986, P.L. 99-514, Section 1542(b), 100 Stat. 2086, first required IRC 501(c) organizations to pay estimated tax on unrelated business income and private foundation tax liabilities, a requirement now contained in IRC 6655(g)(3). That provision, however, does not apply to the IRC 527 tax. Thus, political organizations continue to be excepted from the estimated tax provisions.

IRC 6012(a)(6) and regulations thereunder provide return requirements for 527 organizations. If taxes are imposed for a taxable year, the organization must file a return (Form 1120-POL), within the time provided in IRC 6072(b) (on or before the 15th day of the third month after the close of the organization's fiscal year).